

Message Text

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INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06 SP-02

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC 5495

INFO AMEMBASSY BERN

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DEPARTMENT PASS TREASURY AND DRB

E.O. 11652: L/A

TAGS: ECON, UK

SUBJECT: ECONOMIC DEVELOPMENTS - WEEK ENDING OCTOBER 10

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BEGIN SUMMARY: AMID CALLS FOR A RETURN TO THE VIRTUES

OF THE FREE ENTERPRISE SYSTEM AT THE ANNUAL TORY PARTY CONFERENCE, THE STATISTICS AND CLIMATE OF RECESSION CONTINUED TO DOMINATE THE ECONOMIC SCENE. THE GOVERNMENT'S BORROWING REQUIREMENT IS RISING AS INFLATION PUSHES UP TOTAL SPENDING; RETAIL SALES AND BANK LENDING TO THE PRIVATE SECTOR REMAINED DEPRESSED WHILE REAL DISPOSABLE INCOME AND REVISED GROSS DOMESTIC PRODUCT FIGURES FOR THE QUARTER FELL SHARPLY IN REAL TERMS. THERE WAS A SLIGHT GLIMMER OF HOPE IN TWO SURVEYS OF BUSINESS OPINION AND INTENTIONS WHICH SHOWED A GROWING FEELING THAT THE ECONOMY HAS FULLY REACHED OR PASSED THE LOW POINT OF THE PRESENT RECESSION. END SUMMARY

1. REAL DISPOSABLE INCOME IN THE SECOND QUARTER FELL BY ALMOST 3 PERCENT. WITH ONE EXCEPTION, THIS IS THE LARGEST QUARTERLY DROP ON RECORD, SINCE THE CENTRAL STATISTICAL OFFICE BEGAN COMPILING THE DATA 20 YEARS AGO. BEHIND THE SECOND QUARTER DECLINE LAY SHARP ACCELERATION OF PRICE INCREASES TO WHICH THE BUDGET MEASURES, I.E., TAX INCREASES AND ENCOURAGEMENT TO NATIONALIZED INDUSTRIES TO RAISE PRICES AND REDUCE THEIR DEFICITS GAVE ADDED EMPHASIS.

2. REVISED GDP FIGURES FOR SECOND QUARTER CONFIRM THE WIDENING AND DEEPENING OF THE RECESSION IN THE FIRST HALF YEAR. AT CONSTANT FACTOR PRICES, THE OUTPUT GDP INDEX FELL TO 106.4 FROM 109.4 IN THE FIRST QUARTER (1970 EQUALS 100), A DROP OF 2.7 PERCENT.

THE OUTPUT INDEX HAS NOW FALLEN BELOW THAT OF THE STRIKE-AFFECTED FIRST QUARTER OF 1974 (107.7) AND IS AT THE LOWEST LEVEL SINCE THE THIRD QUARTER OF 1972 (105.4). GDP ON AN OUTPUT BASIS IN THE FIRST HALF OF 1975 SHOWS A FALL OF 2.3 PERCENT FROM THE SECOND HALF OF 1974. THE MOPE BROADLY BASED AVERAGE GDP ESTIMATE INDEX SHOWS A FALL OF 2.4 PERCENT IN THE SECOND QUARTER (107.4, FROM 110.0 IN THE FIRST), WHILE FIRST HALF 1975 OVER SECOND HALF 1974 SHOWS A DECLINE OF 2.1 PERCENT. INDEED, THE ONLY COMPONENT OF TOTAL NATIONAL EXPENDITURE TO SHOW ANY INCREASE IN THE SECOND QUARTER HAS BEEN PUBLIC AUTHORITIES CURRENT SPENDING ON GOODS AND SERVICES (SEE FOLLOW-UNCLASSIFIED

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ING ITEM)

3. GOVERNMENT SPENDING SHARPLY HIGHER. CENTRAL GOVERNMENT EXPENDITURES FOR THE FIRST SIX MONTHS (APR. - SEPT.) OF THE CURRENT FISCAL YEAR WERE 47 PERCENT HIGHER THAN THE CORRESPONDING FIGURE FOR THE 1974-75 FISCAL YEAR. AT 16.9 BILLION POUNDS, EXPENDITURES THROUGH SEPTEMBER REPRESENT 55 PERCENT OF THE 30.9 BILLION POUNDS BUDGETED

FOR CENTRAL GOVERNMENT TRANSACTION IN THE 1975-76 FISCAL YEAR. INFLATION-FUELED INCREASES OF 77 PERCENT IN GRANTS TO LOCAL GOVERNMENT AUTHORITIES, 46 PERCENT IN HEALTH SERVICE EXPENDITURES AND 39 PERCENT FOR SOCIAL SECURITY ASSISTANCE HAVE SERIOUSLY DISTORTED ORIGINAL EXPENDITURE ESTIMATES. ON THE REVENUE SIDE' RECEIPTS WERE 13.3 BILLION POUNDS DURING THE APRIL - SEPTEMBER PERIOD. THE LARGER THAN ANTICIPATED GAP BETWEEN REVENUE AND EXPENDITURES TRANSLATES INTO A GOVERNMENT BORROWING REQUIREMENT WHICH SEEMS LIKELY TO REACH A LEVEL IN THE RANGE OF 11 BILLION POUNDS RATHER THAN THE 9 BILLION POUNDS ORIGINALLY ESTIMATED. THE FINANCING OF THE BORROWING REQUIREMENT THROUGH THE SALE OF GOVERNMENT DEBT TO THE PUBLIC IS BECOMING MORE DIFFICULT AS RISING SHORT-TERM INTEREST RATES DEPRESS THE PRICE OF GOVERNMENT GILT-EDGED SECURITIES. IN ALL LIKELIHOOD, THIS

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FM AMEMBASSY LONDON

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INFO AMEMBASSY BERN

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MEANS THE GOVERNMENT WILL HAVE TO INCREASINGLY MONETIZE
THE DEBT BY SELLING TREASURY BILLS TO THE BANKING SYSTEM
WITH THE CONSEQUENT EXPANSIONARY IMPACT ON THE MONEY SUP-
PLY.
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4. 11.5 PERCENT DROP EXPECTED IN MANUFACTURING INVEST-
MENT. THE AUG-SEPT. DEPARTMENT OF INDUSTRY SURVEY OF
INVESTMENT INTENTIONS SHOWS THAT A DROP OF 11.5 PERCENT
IN MANUFACTURING INVESTMENT IS EXPECTED IN 1975 WITH A
FURTHER DECLINE OF 5 PERCENT IN 1976. THIS COMPARES WITH
THE JUNE SURVEY WHICH FORECAST A 15 PERCENT DECLINE THIS
YEAR WITH NO CHANGE IN 1976.

INVESTMENT IN ENGINEERING, TEXTILES AND FOOD INDUSTRIES
IS EXPECTED TO BE OFF SHARPLY WHILE INCREASES ARE FORE-
SEEN IN COAL, PETROLEUM, CHEMICALS AND METAL MANUFACTUR-
ING.

5. FINAL RETAIL SALES FIGURE FOR AUGUST. THE AUGUST IN-
DEX OF RETAIL SALES VOLUME (1971 EQUALS 100, S.A.) WAS
REVISED FROM 105 TO 104.9 VIRTUALLY UNCHANGED FROM THE
JUNE AND JULY FIGURES OF 104.5 AND 104.7, RESPECTIVELY.
SALES VOLUME DURING THE THREE MONTHS THROUGH AUGUST WAS
5.3 PERCENT LOWER THAN IN THE THREE MONTHS TO MAY. THE
SHARPEST DECLINES WERE REGISTERED IN SALES OF DURABLE
GOODS WHOSE MONTHLY VOLUME DURING JULY AND AUGUST WAS
15 PERCENT LOWER THAN THE AVERAGE FOR THE FIRST 6 MONTHS
OF 1975. IN COMPARISON, SALES OF FOOD SHOPS, CLOTHING
SHOPS AND FOOTWEAR WERE DOWN BY 1 TO 1.5 PERCENT ON A
SIMILAR BASIS. THE OVERALL AUGUST INDEX IS 6.2 PERCENT
LOWER THAN IN AUGUST 1974.

6. INSTALMENT CREDIT AND CONSUMER DEBT. FINANCE HOUSES

AND RETAILERS ADVANCED 235 MILLION POUNDS IN INSTALMENT CREDIT IN AUGUST. THE TOTAL VALUE OF RETAILERS' SALES ON CREDIT WAS 206 MILLION POUNDS UNCHANGED FROM JUNE AND JULY AND SLIGHTLY BELOW THE 224 MILLION POUNDS AVERAGE FOR THE THREE MONTHS ENDING IN MAY. OUTSTANDING CONSUMER DEBT TO RETAILERS SHOWED A SMALL INCREASE IN AUGUST WHILE DEBT TO FINANCE HOUSES DECLINED BY 19 MILLION POUNDS. AT THE END OF AUGUST THE TOTAL AMOUNTS OUTSTANDING TO RETAILERS AND FINANCE HOUSES WERE 2.24 BILLION POUNDS OR 3 PERCENT LESS THAN THE AUGUST 1974 LEVEL.

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7. BANK ADVANCES RISE. THE BANK OF ENGLAND REPORTED THAT BANK ADVANCES TO UK RESIDENTS ROSE BY 715 MILLION POUNDS FOR THE THREE MONTHS TO MID-AUGUST. WHILE THE ENTIRE INCREASE WAS IN THE FOREIGN CURRENCY LENDING CATEGORY, ABOUT 75 PERCENT OF THIS WAS DUE TO THE RISE IN THE STERLING VALUE OF EXISTING FOREIGN CURRENCY LOANS RATHER THAN THE EXTENSION OF FURTHER CREDIT. STERLING DENOMINATED ADVANCES FELL BY 20 MILLION POUNDS. THIS ACTIVITY INDICATES AN EVEN SHARPER FALL IN THE UNDERLYING TREND SINCE SEASONAL FACTORS MIGHT HAVE BEEN EXPECTED TO RAISE STERLING ADVANCES BY 200 TO 300 MILLION POUNDS. ON A SECTORAL BREAKDOWN ADVANCES TO MANUFACTURING INDUSTRY DROPPED BY 65 MILLION POUNDS WHILE THOSE TO "OTHER PRODUCTION," MOST LIKELY NORTH SEA DEVELOPMENT, ROSE BY 180 MILLION. ADVANCES TO SERVICES ROSE BY 450 MILLION POUNDS OF WHICH 330 MILLION WAS IN FOREIGN CURRENCY. PUBLIC SECTOR BODIES FIGURE LARGELY IN THE FOREIGN CURRENCY COMPONENT ALTHOUGH THERE WAS A SHARP RISE (170 MILLION POUNDS) IN ADVANCES TO DISTRIBUTIVE SERVICES.

8. AUTOMOBILE PRODUCTION RISES IN SEPTEMBER. U.K. OUTPUT IN AUTOMOBILES IN SEPTEMBER WAS 111 THOUSAND, UP 11 PERCENT FROM THE 99.9 THOUSAND CARS PRODUCED IN SEPTEMBER 1974. PRODUCTION OF CARS DURING THE FIRST 9 MONTHS OF 1975 IS ESTIMATED TO HAVE BEEN 18 PERCENT BELOW THE CORRESPONDING 1974 FIGURE. OUTPUT OF COMMERCIAL VEHICLES IN SEPTEMBER WAS 34,200 UNITS, DOWN 8 PERCENT FROM SEPTEMBER 1974. HOWEVER, OVER THE SAME 9 MONTH PERIOD TOTAL 1975 COMMERCIAL VEHICLE OUTPUT WAS JUST 1.9 PERCENT BELOW THE COMPARABLE 1974 FIGURE.

9. MONTHLY BUSINESS SURVEY LESS GLOOMY. THE MONTHLY SURVEY OF BUSINESS OPINION PUBLISHED BY THE FINANCIAL TIMES SHOWS BUSINESSMEN ARE SLIGHTLY MORE OPTIMISTIC ABOUT THE GENERAL BUSINESS SITUATION. THE OVERWHELMING MAJORITY (72 PERCENT) EXPECT HIGHER EXPORTS OVER THE NEXT 12 MONTHS. COSTS ARE SEEN AS MODERATING WITH ABOUT 40 PER-

CENT OF RESPONDENTS BELIEVING THAT WAGE INCREASES WILL BE
IN 10-14 PERCENT RANGE (COMPARED WITH 7 PERCENT LAST

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SPRING). UNIT COSTS ARE ALSO EXPECTED TO RISE AT A SLOWER RATE. THERE IS A GENERAL BELIEF THAT THE ECONOMY IS STILL IN A DEEP RECESSION. 53 PERCENT OF RESPONDENTS REPORTED A DECLINING TREND IN NEW ORDERS. THIS FIGURE UNCLASSIFIED

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HAS INCREASED IN EVERY MONTH SINCE JUNE. THE SAME TREND EXISTS IN EXPECTATIONS ABOUT SALES WITH ONLY 22 PERCENT EXPECTING THEM TO RISE. EIGHTY PERCENT OF RESPONDENTS POINTED TO WEAK DEMAND AS THE MAIN FACTOR CURRENTLY AFFECTING OUTPUT WHILE HALF SAID THAT LOW EXPORT ORDERS WERE ALSO A FACTOR. SUPPLY SIDE DIFFICULTIES WERE NEGLIGIBLE. IN THE FACE OF THIS WEAKNESS BOTH IN DOMESTIC AND FOREIGN DEMAND ONLY 8 PERCENT SAID THEY WERE OPERATING ABOVE PLANNED LEVELS OF OUTPUT WHILE 45 PERCENT SAID THEY WERE AT PLANNED LEVELS AND 47 PERCENT BELOW THEM. NEVERTHELESS, THE PERCENTAGE EXPECTING PROFIT MARGINS TO IMPROVE INCREASED FROM 15 TO 24 PERCENT WITH 37 PERCENT EXPECTING NO CHANGE, 38 PERCENT EXPECTING A CONTRACTION AND 1 PERCENT HAVING NO COMMENT.

10. EXCHANGE RATE AND GOLD:

(DATES)	10/2	10/9	CHANGE
EXCHANGE RATE	\$2.0395	\$2.0480	UP 0.85
EFFECTIVE DEPRECIATION			
(PERCENT)	29.4	29.3	NARROWED 0.1
GOLD	\$143.25	\$140.25	DOWN \$3.00

11.FORWARD DISCOUNT ON STERLING:

(DATES)	10/2	10/9	CHANGE
1 MONTH	0.65	0.85	UP 0.20
3 MONTHS	1.75	2.35	UP 0.60
6 MONTHS	3.35	4.15	UP 0.80

(ALL FIGURES IN CENTS)

12.EURODOLLAR INTEREST RATES:

(DATES)	10/2	10/9	CHANGE
1 MONTH	7-1/4	6-7/8	DOWN 3/8
3 MONTHS	8-1/4	7-3/4	DOWN 1/2
6 MONTHS	8-7/8	8-1/4	DOWN 5/8

13. LOCAL AUTHORITY DEPOSIT RATES:

(DATES)	10/2	10/9	CHANGE
1 MONTH	10-7/16	11-5/16	UP 7/8

3 MONTHS 10-15/16 11-11/16 UP 3/4
6 MONTHS 11-1/16 11-13/16 UP 3/4

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14. THE MINIMUM LENDING RATE REMAINS UNCHANGED AT 12 PER-
CENT AS OF FRIDAY, OCTOBER 10, 1975.

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